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Legislation
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PERSONNEL NOTES

21 November 1985
D/Pers 123

Director of Personnel Note

Potential Tax Changes to Federal Retirement Annuities

Mike Causey in his 17 and 19 November 1985 columns in the Washington Post reported that the House was considering an Administration tax reform proposal affecting future retirees. This proposal would make all retirement annuities, including Federal annuities, subject to immediate Federal income taxation upon retirement, rather than the current system which allows a tax-free period until the retiree's contributions to the retirement fund are recovered. Copies of both the articles are attached. These columns give the impression that Congressional action on this proposal is imminent and could be enacted before the end of the year. This has generated a number of calls from concerned employees about the status of this issue, particularly those planning to retire in the near future.

Please advise your component employees that while the House is currently considering the tax reform proposals, the Senate is unlikely to take up the issue until next year. Things are too indefinite at this time to predict the outcome of tax reform legislation or what the effective dates will be, let alone how this will impact on taxing retirement benefits. While acknowledging the vagaries of the legislative process, at this time there is no reason for anyone to be concerned about imminent changes being brought about by this proposal. We are staying close to this subject and will advise employees immediately if there is any change in this status. An Employee Bulletin is also being issued on this matter.

STAT

Robert W. Magee

Attachments:
As Stated

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THE FEDERAL DIARY

Pension Talks to Start

Tax Changes

Ten House members have appealed to the Ways and Means Committee to reconsider a proposal in President Reagan's tax reform plan that would eliminate the tax-free, post-retirement period on pensions of federal, state and local government workers.

The committee okayed the provision Wednesday, but the final tax bill will be subject to a Senate-House conference.

Government employes contribute 7 percent of their salary toward their retirement program. When they retire their annuities are tax-free until they have recovered all the money they put into the program. That tax-free period usually lasts about 18 months.

Under the president's tax plan, those contributions would be subject to immediate taxation, and the amount the employe contributed would be spread actuarily based on the retiree's expected lifetime.

The legislators argue that such a proposal, scheduled to go into effect in January if the tax bill is approved, would work a hardship on employes and spur many of them to retire before the change goes into effect.

Protesting the change are Reps. Frank R. Wolf, Stan Parris, G. William Whitehurst and Herbert H. Bateman, all Republicans from Virginia; Maryland Democrats Michael D. Barnes and Steny H. Hoyer; Maryland Republicans Roy Dyson and Marjorie S. Holt, and Rep. Vic Fazio (D-Calif.).

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THE FEDERAL DIARY

Tension Over Pensions

By Mike Causey
Washington Post Staff Writer

The U.S. government could be swamped with retirements in the next few weeks as senior employes try to beat a proposed pension tax change deadline in the president's tax reform bill.

One provision of the bill would subject annuities that start in 1986 to immediate taxation. Right now, federal, state and local government workers (and others who contribute toward their retirement) have a time period after they retire when their annuities are not taxed.

The tax reform bill before Congress would change all that.

Federal personnel officials say they've had a steady stream of questions about the proposed pension tax for some time. But they say the number of queries from anxious workers jumped after an item was published here Sunday about House action on the proposed change.

"Everybody is asking what is going on, and 'Should I get out now?' " a personnel officer said, "and all we can tell them is the legislative situation, which is about as clear as mud."

About a fifth of the government's 2.8 million employes are currently eligible to retire. In fiscal year 1983, the last year for which statistics were available, nearly 81,000 employes retired.

Federal employes contribute 7 percent of their salaries to the retirement fund. They pay taxes on those contributions as part of their gross income.

Currently, when employes retire, the pensions aren't taxed until the individuals get back whatever they put in (since that money has already been taxed). On average, it takes about 18 months for a retiree to recover those contributions. During that period the annuity is untaxed. The tax-free period can be as long as three years.

Many civil servants use the tax-free period to cash in stocks or bonds, or to work at other jobs so that income from those sources will be taxed at lower rates than if their annuities were also counted as income.

President Reagan's tax reform bill proposes that annuities that begin in 1986 be taxed from the first day. The amount of pension subject to taxation would be prorated based on actuarial life expectancy.

Persons already drawing federal pensions, or those who retire before the deadline, would not be subject to the change. That is the important and tricky part.

Last week the House Ways and Means Committee approved the pension tax change, over the objections of local members of Congress, the Senior Executives Association (whose relatively high-paid members would be especially hard hit) and federal and postal unions.

This is where the deadline uncertainty comes in: The House bill says feds who retire by Dec. 31 could retain the current tax-free period. The administration plan would require feds to retire by Dec. 3, giving them even less time to make a decision.

Persons retiring after the deadline (whatever it is) would be subject to the new rules, and immediate pension taxes, if the tax reform package becomes law.

Some Congress-watchers believe it will be summer before any reform bill is passed. But when it passes is less important than the effective dates and deadlines. That is why it is important for federal employes who want to have a tax-free period for their annuities to do some serious thinking.

But please don't rush out and retire based on this information alone!

A lot could happen to tax reform, including nothing. The bill may be stalled, delayed or never approved. It could get a new effective date, or a new deadline could be set for federal workers. Nobody knows what will happen.

But you should keep an eye on the progress of the tax reform bill, and also inquire at your agency's personnel/retirement office about your options.

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